



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

JUN -4 2001

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You stated in your original application that you will operate a residential care facility for troubled youth in [REDACTED]. You stated as follows in Part II of your Form 1023:

This project will provide 24-hour residential services to youth. The programming is designed to meet the comprehensive needs of the youth we care for. The care and services provided at this facility will be centered around youth issues, structured living, education and positive growth.

In your letter dated [REDACTED], you informed us that you changed your purpose to supportive housing for the elderly.

Your current purpose of providing housing for the elderly has not been fully described with respect to the qualification and selection of the residents of your facility, nor as to any planned adaptation of the facility from its current state in order to prepare for supportive housing for the elderly. You have not sent us any specifics on how you will operate this facility as housing for the elderly. You have also not informed us of the price structure you will use in charging rent to these residents, and how residents who have been admitted and later run out of funds will be treated at your facility. You have given us limited financial data with respect to your projected receipts and expenses of your operations. You state in your [REDACTED] letter that you do not have a current operating budget for supportive housing for the elderly.

All your activities, with respect to both your original purposes, education and student housing, and your current purpose, supportive housing for the elderly, are planned to occur in the same building, located at [REDACTED]. This building is owned by [REDACTED], which is owned by [REDACTED].

You were incorporated by [REDACTED] his wife, [REDACTED] and [REDACTED]. [REDACTED] is your Executive Director and [REDACTED] is your Associate Director. Two of your six appointed Directors are [REDACTED].

You have not told us the name of the new management company which will manage your proposed operations. You have not given us a name of any independent management company which will be involved with your operations. You have not given us data on how your future management company

will charge you for meals, utilities, nursing and social service staff, resident activities and therapeutic sessions, if any.

There is no evidence of any bidding or selection process in selecting your former management company, or in selecting the location of your facility.

are the shareholders who own and control a for-profit corporation which owns your planned facility. bought this property before you were incorporated. will charge you rent in order to use this facility. You have not sent us a copy of any lease between you and . You have told us that your building is not currently in operating condition. This building was built in as an apartment building and needs significant renovation. In order to be used as an elder care residential facility.

Three of your six Board members will receive compensation for the services they will perform for you. You state that will each be paid \$ per year for their duties as residential care facility operators, and that Director will be paid a consultant's fee of \$ per hour for at least ten hours of work per week. You have no conflict of interest policy, although we requested that you send us one in our letter dated Question 1b.

You were incorporated on . You have not had any Board meetings to date.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for health care purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The section cross references the definition of private shareholder which is contained in section 1-501(a)(1)(c). That section provides that the words private shareholder or individual in section 501 refers to person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Situation 2 of Rev. Rul. 69-545, 1969-2 C.B. 117, describes a hospital, otherwise serving a charitable purpose, that was denied exemption under section 501(c)(3) of the Code because it served a private interest more than incidentally. The revenue ruling states that in considering whether a nonprofit organization claiming charitable exemption is operated to serve a private benefit the Service will weigh all of the relevant facts and circumstances in each case.

Rev. Rul. 76-441, 1976-2 C.B. 147, ruled that a nonprofit organization that purchases or leases at fair market value the assets of a former for-profit school and employs the former owners, who are not related to the current directors, at salaries commensurate with their responsibilities is operated exclusively for educational and charitable purposes. An organization that takes over a school's assets and its liabilities, which exceed the value of the assets and include notes owed to the former owners and current directors of the school, is serving the directors private interest and is not operated exclusively for educational and charitable purposes.

Rev. Rul. 72-124 sets forth the requirements that homes for the elderly must meet in order to gain exemption under Sec. 501(c)(3). Such homes will be deemed "charitable" if they meet the special needs of the elderly, such as the need for health care, financial security, and residential facilities designed to meet specific physical, social and recreational requirements of the elderly. These homes are not required to provide direct financial assistance in order to be considered "charitable" under the Code.

Rev. Rul. 79-18 and Rev. Rul. 79-19 deal with exemptions for rental housing for the elderly. In Rev. Rul. 79-18 the Service held that a rental housing program that:

- 1) provides specifically designed housing for the elderly, and
  - 2) that is within the financial reach of a significant segment of the community's elder population, and
  - 3) commits itself to operating such housing at the lowest feasible cost, and
  - 4) maintains in residence those tenants who become unable to pay its monthly fee,
- is exempt as a charity under Sec. 501(c)(3).

Rev. Rul. 79-19 is similar to Rev. Rul. 79-18, with the additional fact that the facility was built specially for the physically handicapped. Under both Rev. Rules, the charity keeps a reserve fund adequate to pay for the life care of any of its residents who may require it.

In Plus XII Academy, Inc. v. Commissioner, T.C. Memo 1982-97 (1982), the Court held that where an organization was set up as a tax-exempt school, but had no building nor any students, but had plans for using bingo as a fund raiser the organization failed the "operational test" of Section 501(c)(3), and that the exemption request should be denied. The Court held that only vague generalizations of the type of operations an organization had planned is not enough to support a request for exemption under this code section.

In P.L.L. Scholarship v. Commissioner, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was self-perpetuating. The Court reasoned that since the owners controlled the bar and appointed its future directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The Court was not persuaded. It went on to conclude that the organization had a substantial nonexempt purpose.

Similarly, in Church by Mail v. Comm'r., 765 F.2d 1387 (9<sup>th</sup> Cir. 1985), aff'g. TCM 1984-349 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501. (c)(3) of the Code of a non-profit corporation that conducted continuing medical education tours. The petitioner had three trustees. Mr. Helin, who was a shareholder and the president of H & C Tours, a for-profit travel agency. Mr. Regan, an attorney, and a third director who was ill and did not participate. Mr. Helin served as executive director. The petitioner shared offices with H & C Tours. The petitioner used H & C Tours exclusively for all travel arrangements. The petitioner's contract with H & C Tours permitted it to acquire competitive bids, but provided that H & C Tours would always get the bid if it was within 2.5%. There is no evidence that the petitioner ever sought a competitive bid. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency.

[REDACTED]

In *KJ's Fund Raisers, Inc. v. Commissioner*, T.C. Memo 1997-424 (1997), affirmed 82 AFTR 2d 7092 (1998), the Tax Court found that a gaming organization was not exempt. While the organization raised money for charitable purposes, it also operated for the substantial benefit of private interests. The organization's founders, Kristine Hurd and James Gould, were the sole owners of a bar, KJ's Place. The organization, through the owners and employees of KJ's Place, sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages from the bar. The initial directors were Hurd, Gould, and a related individual. The initial board was replaced several times until Hurd and Gould were no longer on the board. At all times Hurd and Gould were the organization's officers. Salaries had been paid to Hurd and Gould and rent had been paid to KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The Court concluded that KJ's Fund Raisers was operated for substantial private benefit and did not qualify for exemption. The Court of Appeals affirmed the decision. It found that the organization had served the private interests of its directors in maintaining and augmenting their business interests.

We have reviewed your proposed activities and based upon the information provided we have reached the conclusion that you have failed to establish that you are organized exclusively for an exempt purpose within the meaning of section 501(c)(3) of the Code. You have failed to establish an exempt purpose in your Articles of Incorporation because you have told us that you will not maintain a school for youths in your facility, nor have you amended your Articles of Incorporation to list the purpose of housing for the elderly. You have told us that you will operate a home for the elderly but have not provided us with any details as to how your home will operate. You have also not established that you have a feasible facility to operate a home for the elderly. It is not sufficient for you to only state that you will provide housing for the elderly in order to receive exemption under section 501(c)(3). You must also show that your facility will meet the special needs of the elderly, such as the need for health care and financial security. See Rev. Rul. 72-124 and Rev. Rul. 79-18. Since you have failed to give us this information, you have failed to show that you comply with these Revenue Rulings. Therefore, you have not established that you will operate for charitable purposes by meeting the special needs of the elderly. Therefore, you do not have an exempt purpose, as required under Section 1.501(c)(3)-1(a)(1) of the regulations.

You have informed us that two of your Directors, [REDACTED], will profit from this organization via wages, management fees, and lease payments. Also, Director [REDACTED] will also be paid for her services rendered to you. Thus, at least three of your six Directors have a financial interest in your organization, and are allowed to vote on matters affecting them. You have not signed any conflict of interest policy after we asked you to do so. You have not proved that any of the payments payable to the Board members are reasonable now, or will be so in the future. You have not established that inurement or private benefit will not be present. You will rent your building from [REDACTED] for-profit company. [REDACTED] They will manage it through their for-profit management company, or by themselves as individuals. [REDACTED] have shown that they intend to be paid for their services rendered to this company and to any related entities they have created. They, or their related companies, will receive both rental payments and salaries as consultants from each and every type of exempt organization which they have created to occupy their building. Thus, even if we assume that you will operate exempt housing for the elderly, the private benefits to your Directors outweigh the public benefits of having housing for the elderly. Therefore, for the reason given in Rev. Rul. 69-545, your exemption request should also be denied. Also, see sections 1.501(c)(3)-1(c)(2) and 1.501(c)(3)-1(d)(1)(ii) of the regulations and the court cases cited above for support for this decision.

Thus, you have not established that you will operate for exempt purposes, and your Directors have private interest and private benefit based on their income from wages, management fees, and rent from the building in which they own and operate. Accordingly, you are not organized or operated exclusively for charitable purposes, as is required under section 501(c)(3). Based upon the facts above, we have concluded that you are not organized or operated for exempt purposes as described in section 501(c)(3) of the Code. Therefore, it is our conclusion that you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

[REDACTED]

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-6500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
T:EO:RA:T:4 Rm. 3E5  
Attn: [REDACTED]  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack  
Manager, Exempt Organizations  
Technical Group 4

[REDACTED] [REDACTED]